

DIRECT TESTIMONY OF

JIMMY E. ADDISON

ON BEHALF OF

SOUTH CAROLINA ELECTRIC & GAS COMPANY

DOCKET NO. 2005-113-G

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION.

A. My name is Jimmy E. Addison and my office is located at 1426 Main Street, Columbia, South Carolina. I am Vice President, Finance of South Carolina Electric & Gas Company ("SCE&G") and hold a similar position at SCANA Corporation, which is the parent company of SCE&G.

Q. PLEASE DESCRIBE YOUR EDUCATION AND BUSINESS BACKGROUND.

A. I am a graduate of the University of South Carolina with a Bachelor of Science Degree in Business Administration, majoring in accounting, and a Master of Accountancy Degree. Also, I am a Certified Public Accountant in South Carolina. Prior to my employment by the Company in March 1991, I was employed for seven years by the certified public accounting firm of Deloitte & Touche, where I was designated an Audit Manager as a public utility accounting and audit specialist. I was also a partner in the public accounting firm of Hughes, Boan and Addison immediately prior to joining

1 the Company. I currently serve as treasurer of the Southeastern Electric
2 Exchange.

3 **Q. WHAT ARE YOUR DUTIES WITH SCE&G?**

4 **A.** As Vice President, Finance of SCE&G, I have responsibility for
5 planning, directing and overseeing the finance, accounting, treasury,
6 investor relations, sourcing and information technology functions.

7 **Q. HAVE YOU EVER TESTIFIED BEFORE THIS COMMISSION?**

8 **A.** Yes. I have testified in several proceedings before this Commission
9 including SCE&G's 1992, 1995 and 2004 electric rate cases.

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 **A.** The purpose of my testimony is to provide an overview of the
12 financial status of SCE&G's natural gas operations as it relates to the
13 decision to seek rate relief at this time. I will also testify concerning the
14 perspectives of the financial community on the Company and this
15 proceeding and why the 11.75% Return on Equity ("ROE") requested in the
16 Application is a reasonable ROE for the Company's gas operations at this
17 time.

18 **SCE&G'S GAS OPERATIONS**

19 **Q. WHEN DID SCE&G FILE ITS LAST GENERAL RATE**
20 **PROCEEDING WITH THE COMMISSION?**

21 **A.** The Company filed its last general rate increase request on June 1,
22 1989, in Docket No. 89-245-G. At the time, the Commission granted

1 SCE&G a 12.75% return on equity and established the current rates to
2 generate that return.

3 **Q. WAS THE ALLOWED ROE SUBSEQUENTLY ADJUSTED?**

4 **A.** Yes. In Docket No. 91-342-G, the Commission requested and the
5 Company agreed to lower the allowed ROE to 12.25%. This reflected
6 changes in economic conditions that occurred during the intervening years.
7 This did not result in any adjustment in the rates approved in Docket No.
8 89-245-G.

9 **Q. HOW HAVE SCE&G'S GAS OPERATIONS CHANGED**
10 **FINANCIALLY SINCE 1989?**

11 **A.** As the president of the Company, Mr. Lorick, has testified,
12 SCE&G's natural gas distribution system has grown substantially since
13 1989. Mr. Lorick has described that growth from a customer and
14 operational perspective in terms of miles of mains operated, numbers of
15 customers served, and peak demands on our system.

16 From a financial perspective, a key indicator of changes since 1989
17 is the change in margin revenue. Margin revenue is the term used to
18 describe the revenue earned by the Company after deducting the cost of
19 gas. The cost of gas is passed through to customers through the Purchase
20 Gas Adjustment proceedings. In effect, margin revenue reflects the pool of
21 funds available to the Company to pay employees' salaries, to make safety
22 and reliability investments, and to pay taxes, depreciation, cost of debt and

1 equity capital, and all other costs of operations.

2 During the 16 year period that current rates have been in effect, the
3 Company's margin revenues have grown principally due to the growth in
4 the number of customers. In Order 89-1074, the Commission set rates that
5 would generate margin revenue of \$50.1 million based on the test year
6 ended March 31, 1989. For the adjusted test period in this proceeding,
7 those same rates generated margin revenue of \$71.9 million, an additional
8 \$21.8 million dollars.

9 This growth in margin revenue reflects the positive effect of adding
10 new customers to the system, and the additional demand and sales revenue
11 that new customers represent. This revenue growth, along with general
12 efficiency and productivity gains during the period, is a principal reason
13 that the Company was able to sustain reasonable earnings on its gas
14 operations until recent years and has been able to avoid a rate filing until
15 this point. There are, however, limits to the degree to which customer
16 growth and other factors can sustain reasonable financial results for a gas
17 distribution system like SCE&G's over time.

18 **Q. PLEASE EXPLAIN.**

19 **A.** There are several reasons why growth alone cannot sustain returns
20 over time. One reason is that SCE&G, like other businesses, is subject to
21 the effects of general inflation in the economic system. As measured by the
22 consumer price index, inflation has totaled 50.9% during the period current

1 rates have been in effect. Inflation increases the cost of serving both new
2 and existing customers. While inflation can be offset to some degree by
3 efficiency and productivity gains, its effects on rates cannot be avoided
4 indefinitely.

5 Another reason why revenue growth itself is not enough to sustain
6 financial results is the way rate base changes over time. As a utility like
7 SCE&G expands to serve new customers and repairs and replaces aging
8 portions of its system, it adds new assets to its rate base. The cost of those
9 assets reflect today's prices, not prices from years past as is the case for
10 older assets on the system. In addition, the cost of those new assets is not
11 substantially reduced by depreciation, as is the case for assets placed in
12 service in years past.

13 During the 16 years since the last rate proceeding, expansion of the
14 system to serve new customers, investments in new technologies, and the
15 repair and replacement of aging portions of the system have increased the
16 amount of SCE&G's net investment in rate base for gas operations. That
17 investment has increased from \$128 million in 1989 to \$268 million today,
18 an increase of 109%. This reflects a compound growth rate of slightly less
19 than 5% per year over the period.

20 This growth in rate base reflects the investment required to provide
21 safe and efficient natural gas service to a rapidly expanding service area. It
22 shows that SCE&G is following through on its commitment to provide

1 energy infrastructure to support development in South Carolina,
2 particularly in the rapidly growing coastal and metropolitan areas.

3 However, this growth in rate base, along with the effects of inflation, mean
4 that rate adjustments cannot be postponed indefinitely.

5 **Q. HOW HAVE OTHER COSTS INCREASED SINCE 1989?**

6 **A.** SCE&G's increased investment in utility assets has resulted in
7 corresponding increase in depreciation expense. In addition, utility systems
8 are major sources of tax revenue for local governments. SCE&G has both
9 gas and electric operations throughout many parts of the State, and year
10 after year is one of the largest if not the largest property taxpayer in South
11 Carolina. During the period since 1989, more and more of the funding
12 responsibilities for local services have been shifted from State and Federal
13 sources to local government. The result has been a substantial increase in
14 millage rates across SCE&G's system. These millage rate increases have
15 combined with the growth of SCE&G's net investment in gas
16 infrastructure. The result is an increase in SCE&G's property taxes related
17 to gas operations from \$2.7 million in 1989 to \$10.4 million in the adjusted
18 test year, an increase of 285%.

19 **Q. HOW DOES THE REQUESTED RATE INCREASE IN THIS**
20 **DOCKET COMPARE TO THESE FIGURES?**

21 **A.** The Company has sought to limit rate increases to customers as
22 long as possible. However, the current earnings on gas operations are

1 clearly inadequate to support on-going investment in the gas system, which
2 is necessary to sustain a safe and reliable system and allow for continued
3 expansion to meet the growth being experienced in parts of our service
4 territory. The Application in this proceeding indicates that, for the adjusted
5 test period ending December 31, 2004, the Company earned a total return
6 on gas operations of 2.67% percent. This return was not sufficient to fully
7 cover the Company's cost of debt related to gas operations. As a result, the
8 Company's Return on Equity for the period was a negative 1.11%.

9 It is not reasonable to expect the Company to continue to operate its
10 gas system with current rates. In this proceeding, SCE&G is requesting a
11 base rate increase of 7.09%. The requested increase is far less than the rate
12 of inflation both we and our customers have experienced over the last
13 sixteen years. The requested increase will support a rate base that has more
14 than doubled over the period and a system that is safely and reliably
15 meeting the needs of new gas customers in places like Sun City, Daniel
16 Island, Dutch Fork and Northeast Columbia. New rates are clearly
17 justified.

18
19 **PERCEPTIONS OF SCE&G AND THIS PROCEEDING IN THE**
20 **FINANCIAL COMMUNITY**

21
22 **Q. IN YOUR ROLE AS VICE PRESIDENT, FINANCE OF SOUTH**
23 **CAROLINA ELECTRIC & GAS COMPANY, WHAT**

1 **INVOLVEMENT DO YOU HAVE WITH CAPITAL MARKETS?**

2 **A.** Along with our Chief Financial Officer, I share responsibility for
3 managing SCE&G's relationships with investors, security analysts, the
4 agencies that rate our debt securities and other members of the financial
5 community. I meet regularly with representatives of all these groups, and
6 participate in the Company's presentations to the equity investment
7 community and to our debt rating agencies. I am actively involved in
8 raising capital for the Company in both debt and equity markets, and meet
9 regularly with underwriters, investment advisers and other representatives
10 of investors in that context.

11 **Q. HOW DO THE NATIONAL FINANCIAL MARKETS VIEW SCE&G**
12 **AND ITS PARENT COMPANY SCANA AT PRESENT?**

13 **A.** SCANA and SCE&G continue to benefit from the fact that our
14 "stick-to-the-basics" approach to utility operations has been well received
15 within the financial community. We are seen as a well-managed company
16 with a sound approach to our core business, which is focused on retail
17 electric and natural gas utility operations in the Southeast.

18 **Q. HOW DO THE RATING AGENCIES RATE SCE&G'S SENIOR**
19 **SECURITIES?**

20 **A.** SCE&G has been able to maintain its Single A debt ratings with
21 Standard & Poor's, Moody's Investors Service and Fitch Ratings despite
22 credit metrics that are relatively weak for that rating category. We

1 communicate regularly and openly with the rating agencies concerning the
2 financial prospects for the Company and the rating agencies' perspectives.
3 While the rating outlook with S&P and Fitch for SCE&G is currently
4 stable, Moody's has issued a "negative" outlook for the rating. A
5 downgrading of the debt rating continues to be a real possibility, especially
6 at Moody's.

7 **Q. WHAT ROLE HAVE SCE&G'S REGULATORY RELATIONS**
8 **PLAYED IN MAINTAINING THE SINGLE A BOND RATING?**

9 **A.** Rating agencies – and the financial community generally –
10 understand that the majority of SCE&G's assets and earnings are associated
11 with regulated operations. The largest single component of those earnings
12 is the earnings regulated by this Commission. Accordingly, it has been my
13 experience that the investment community pays very close attention to this
14 Commission, its Orders, and the approach that it takes in regulating
15 SCE&G. In fact, during a recent presentation I made to Wall Street
16 analysts, more attention was devoted to the discussion of our regulatory
17 environment than any other topic.

18 **Q. HOW DID INVESTORS PERCEIVE SCE&G'S RECENT**
19 **ELECTRIC RATE ORDERS?**

20 **A.** The investment community carefully examined the decisions made
21 by this Commission in the two recent retail electric rate proceedings. It

1 found, on balance, that the decisions were constructive and justified
2 continued confidence in the future financial integrity of SCE&G.

3 Specifically concerning the Single A debt rating, maintaining that
4 rating would have been impossible but for the balanced and constructive
5 regulation SCE&G has received from this Commission. As SCE&G's
6 witnesses have explained in detail in past cases, the investment community
7 is not looking for one-sided regulation. It values utilities that have stable
8 earnings and regulation that is reasonable, consistent and fair to all parties,
9 including both consumers and investors, over the long-term. The
10 Commission's recent SCE&G decisions were seen as largely fitting that
11 mold and allowed the Company to go to the investment community and
12 demonstrate that there was sufficient reason to continue to support the
13 Single A debt rating. We believe a Single A debt rating appropriately
14 balances the interests of customers and investors, and therefore it is the
15 Company's target debt rating at present.

16 **Q. WHY DOES THE COMPANY TARGET THAT PARTICULAR**
17 **DEBT RATING?**

18 **A.** Under current financial conditions, maintaining the Single A rating
19 offers an attractive balance of financial rewards, (specifically lower debt
20 costs), versus the cost of maintaining the required financial ratios. This
21 balance of costs and benefits is a moving target. As financial markets
22 change, as the capital requirements of the Company change, and as the

1 benchmarks and standards of the rating agencies change, the cost-benefit
2 analysis related to maintaining the Single A rating changes. However,
3 based largely on quantitative factors, including its regulatory environment
4 and therefore its stable cash flows, SCE&G has been able to maintain a
5 Single A rating in spite of cash flow coverage ratios that might not have
6 justified a Single A rating for a company with a different quality of
7 regulation.

8 **Q. HOW DOES THE FINANCIAL COMMUNITY VIEW THE**
9 **CURRENT RATE PROCEEDING?**

10 **A.** The financial analysts that follow SCANA and SCE&G understand
11 that this case represents the first base rate adjustment the Company has
12 sought for gas operations in 16 years. They understand that the financial
13 justification for rate relief is strong, *i.e.*, the Company is earning a negative
14 ROE on adjusted gas operations for the test period. At the same time, this
15 case does not center on any novel issues of regulatory policy. It does not
16 involve any major investment decisions by the Company in the way that the
17 last electric rate proceeding centered on the Saluda Dam Remediation
18 Project and the newly completed Jasper Generating Station. In short, the
19 investment community sees this case to be about adjusting rates for overall
20 changes in the cost of doing business over the past 16 years.

21 **Q. WHAT THEN ARE THE KEY ISSUES AS THE INVESTMENT**
22 **COMMUNITY SEES IT?**

1 **A.** The key issues for the investment community in this case are what return
2 on equity the Commission will allow and whether the Company's valid
3 utility expenses are permitted to be recovered in rates. The investment
4 community has perceived recent decisions by this Commission, as a whole,
5 to be reasonable and fair to all parties, respecting and balancing the
6 interests of both consumers and investors. Expectations are that the
7 decision in this case will follow a similar approach as to the major issues
8 involved.

9
10 **THE REQUESTED RETURN ON EQUITY OF 11.75%**

11
12 **Q. WHAT ROE IS THE COMPANY REQUESTING IN THIS CASE**
13 **FOR ITS GAS OPERATIONS?**

14 **A.** The Company has filed its Application based on an ROE of 11.75% and is
15 requesting that the Commission set an ROE at that level.

16 **Q. IN YOUR OPINION, IS THAT AN APPROPRIATE ROE FOR THE**
17 **COMPANY'S GAS OPERATIONS?**

18 **A.** Yes. The Company's cost of capital witness, Dr. Hubbard, has
19 provided the Commission with a detailed cost of capital analysis
20 concerning SCE&G's ROE. He concludes based on the financial tools and
21 models he has used, that a conservative estimate of the required ROE for

1 SCE&G would be 11.14% and that a significantly higher ROE than 11.14%
2 could be supported.

3 As Dr. Hubbard recognizes, the results of the financial tools and
4 models he used must be tested against the realities of the markets and the
5 individual companies involved. Based on my knowledge of the financial
6 community and how it perceives SCE&G specifically, I firmly believe that
7 setting a low ROE could create a negative perception of the regulatory
8 environment and, therefore, of the Company in the investment community.
9 In my opinion, investors' reasonable expectation of a return on equity from
10 SCE&G's gas operation would be significantly higher than ROE numbers
11 falling at the lower end of Dr. Hubbard's calculations.

12 To put it another way, setting an unreasonably low ROE could be
13 perceived as inadequate and could be taken to indicate a fundamental
14 change in the Commission's regulatory perspective on SCE&G as a whole,
15 both its gas and electric operations. The impact on our financial position
16 from such a perception could be substantial and long lasting. There would
17 be no way to begin to correct that perception until SCE&G files its next
18 base rate case Application and the Commission issues an order. Adopting
19 an unduly low ROE in this case could increase the cost of capital to our
20 Company and ultimately the cost of serving its customers.

21 **Q. WHY IS 11.75% AN APPROPRIATE ROE FOR SCE&G'S GAS**
22 **OPERATIONS?**

1 **A.** In my opinion, an ROE at 11.75% would be perceived by the
2 investment community as justified by the financial data and would show
3 continued regulatory support for the Company and its ever growing South
4 Carolina gas operations. For the reasons stated above, it is higher than Dr.
5 Hubbard's point estimate of a reasonable ROE for SCE&G's gas
6 operations, but it is not unduly so.

7 As is always the case, the Commission's ROE decision would have
8 to be placed within the context of the overall order and the other individual
9 decisions that order contains. But all other things being equal, an 11.75%
10 ROE would be considered a constructive ROE for gas operations. It would
11 support the financial integrity of SCE&G and its continued ability to access
12 national capital markets on reasonable terms. An 11.75% ROE in this case
13 would give investors confidence that SCE&G's operations, both gas and
14 electric, would continue to receive balanced and constructive regulation by
15 this Commission.

16 **Q. HOW DO TIMING ISSUES AFFECT THE CHOICE OF A**
17 **PROPOSED ROE?**

18 **A.** From the shorter term perspective, in choosing the 11.75% as the
19 ROE on which to base its Application, the Company understood that a fair
20 ROE is a moving target. Financial markets are evolving quickly. Financial
21 conditions can and will change between the filing of the Application in this
22 case and the date that the Commission makes its decision and issues its

1 order. All indications at the time of preparing that Application were that
2 return expectations in the financial markets will be increasing in the future,
3 resulting in rising interest rates, and the intervening months since our filing
4 have borne this out. This is one reason to choose a ROE in the upper part
5 of Dr. Hubbard's calculations.

6 From the longer term perspective, the ROE that the Commission
7 establishes in this case may be in place for several years. Recent interest
8 rates have been at historically low levels, and result in lower than average
9 ROE results when calculated with financial models. This is another reason
10 for choosing an ROE in the upper part of Dr. Hubbard's calculations.

11 **Q. WHAT OPINION DO YOU HAVE CONCERNING FLOTATION**
12 **COSTS AS A PART OF THE ROE CALCULATION FOR SCE&G?**

13 **A.** I agree completely with Dr. Hubbard's analysis. Flotation costs are
14 a real cost to SCE&G, and the impact that these costs have on our
15 investors' return does not depend on whether an equity issuance has
16 occurred or is anticipated to occur near the time of a rate proceeding.

17 Flotation costs are in fact deducted from the proceeds of capital
18 issuances when they are booked on the Company's balance sheet. Unless
19 the effect of flotation costs are considered in calculating ROE, the return
20 investors receive for the capital they have advanced to the Company will be
21 less than a fair return as determined by the Commission.

1 **Q: DOES THIS CONCLUDE YOUR TESTIMONY?**

2 **A. Yes.**

3